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TAGS: ECON EFIN PL
SUBJECT: POLAND'S ECONOMY STARTS TO HIT ITS STRIDE

WARSAW 00000320 001.2 OF 005

Classified By: Econ Couns. R. Rorvig for reasons 1.4 (b) and (d).

Summary

¶1. (U) Poland's GDP rose 5.8 percent in 2006 to $337 billion, according to the National Statistics Agency, the best performance since 1996. Growth was propelled by a 5.8 percent rise in domestic demand, sharply increased EU funds inflows, and surging investment (up 16.7 percent). Profiting from Poland's EU membership, exports reached $99 billion in the first 11 months of 2006, a jump of 21.5 percent in dollar terms over the same period in 2005. The economic boom was reflected in the strong growth of employment, rising wages, and soaring property markets in major cities. Unemployment fell to 14.9 percent in December, down from 17.6 percent a year ago. With more Poles employed at better wages, consumption by individuals rose 5.2 percent. Inflation remained subdued at about 1.0 percent on a year over year basis, while the Polish Zloty advanced against the dollar and Euro. With tax revenues rising faster than expected, the GOP managed to close the year with a PL 25 billion ($8.3 billion) budget deficit, about PL 5 billion less than originally planned. There is a consensus among Polish economic forecasters that the boom is just beginning. The National Bank of Poland is projecting that GDP growth should be just as strong in 2007, and remain at around 5.0 percent in 2008 and 2009. The even more bullish National Economics Institute sees 6.0 percent growth in 2007. Forecasters expect unemployment to continue to fall rapidly, with the NBP predicting a rate around 10 percent by 2009.

¶2. (U) These strong positives have not gone unnoticed by foreign investors, who see a rapidly growing market for their products in Poland. Despite the recent pick up in job creation, Polish wage rates are still extremely competitive (averaging about $825 per month gross in September 2006). The number of college graduates as a percentage of the 20-30 age bracket is now the highest in Europe. A disproportionately high share of these graduates is in the sciences. Foreign investors regard the country's abundance of reasonably priced engineers and computer scientists as among the top reasons to locate new technology investments in Poland. As a result, Poland attracted over $10 billion in direct investment in 2006, much of it from Asia. Poland emerged as the top destination in Europe for new investments in computers (Dell); plasma and LCD displays/televisions (Toshiba, Funai, LG-Philips, LG Electronics, Orion, TPV);

motor vehicles and parts (Toyota, MAN, TRW, Cooper Standard, Johnson Controls, Michelin); and white goods (Electrolux, Diehl). Initial indications are that 2007 will also be a good year. In January, Poland already was able to announce new investments by Delphi and Kirchhoff (auto parts) and the sale of one of Poland's oldest aircraft firms PZL Mielec to United Technology's Sikorsky Helicopter Division. The main clouds on the horizon are fears that local wages will rise rapidly in the future, stoking inflation and eroding Poland's price competitiveness. End Summary

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Economy Steams Ahead

¶3. (U) The National Statistics Agency (GUS - Glowny Urzad Statisticzny) has confirmed that Poland's economy grew 5.8 percent in 2006, significantly beating consensus forecasts. Growth was propelled by the sharp growth of domestic demand (up 5.8 percent), surging investment (up 16.7 percent), and sharply increased EU net funds inflows (over Euro 3 billion). Benefiting from Poland's EU membership, Poland's exporters saw sales jump 21.5 percent (year/year) to $99 billion in the first 11 months of 2006. Exports to Poland's Central European neighbors rose even faster, highlighting the region's increasing economic integration. For example, Poland's sales to the Czech Republic rose 45.8 percent to $4.4 billion, to Ukraine 55.3 percent to $2.9 billion, and to Hungary 30.5 percent. Imports were also up strongly, rising 20.4 percent to $112.1 billion. Some of the biggest jumps were recorded in purchases from China (up 37.5% to $6.9 billion) and South Korea (up 82.8% to 2.1 billion). Purchases from Russia - made up largely of gas and oil - grew 36.6 percent to $11.1 billion based on higher average hydrocarbon prices.

¶4. (U) Average annual inflation remained subdued, rising only

1.0 percent on a year-over-year basis. However, the pace of inflation gradually rose during the course of the year, hitting 1.4 percent on a 4th quarter 2006/4th quarter 2005 basis. The Polish Zloty more than held its own, advancing about 4-5 percent against both the dollar and the Euro. Stronger than expected tax revenues allowed Poland to hold its central government fiscal deficit to PL 25 billion ($8.3 billion), about 2.4 percent of GDP and significantly less than the Pl 30 billion originally anticipated. (Overall, the consolidated public sector deficit according to the EU's Maastricht methodology is estimated to have been about 3.7 percent GDP according to internal Finance Ministry estimates.) The better than expected performance allowed Poland to hold its total public sector debt as a share of GDP to 48 percent.

Improved Employment Picture

¶5. (U) Buoyed by rising business confidence, the Polish private sector dramatically stepped up hiring, creating almost 500,000 net new jobs in the 12 months to September. Overall, the number of Poles working in the economy reached 14.93 million in the third quarter of 2006, the highest total since February 1999. Unemployment continued its rapid downward path falling to 14.9 percent in December 2006, down from 17.6 percent in December 2005. The number of registered unemployed at year end 2006 totaled 2.309 million, a drop of 463,000 from a year ago. Virtually all educational and age groups have benefited from the improvement. However, the biggest improvement has been for workers 24 and under. These workers were also the most likely to pick up and leave for the UK, Ireland and other EU destinations open to Polish workers.

Unemployment by Age Group III Quarter 2005 III

Quarter 2006
in percent

to 24 years of age	36.3	26.7
25-34	17.7	12.9
35-44	14.0	10.4
45 and older	13.2	9.9
Education		
University/College	7.8	6.0
Vocat. HSl/Junior College	16.2	12.2
General High School	21.2	16.2
Basic vocational	20.4	15.1
Middle/Primary School	24.7	20.2

¶6. (U) Not only are more Poles working, they are earning more. The National Bank of Poland reported that nominal compensation in the enterprise sector (which only includes enterprises with 10 or more employees) was 5.7 percent higher in the third quarter of 2006 than a year earlier. Numerous companies in the skilled trades reported spot shortages of workers and, as a result, rising pressure on wages. Data from the National Statistical Agency show that the average Polish wage in the whole economy rose 4.8 percent to PL 2474 (about $825). The highest average wage increases were achieved by workers in the construction trades (8.4%), real estate (5.6%), manufacturing (5.6%), and mining (5.1%).

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Domestic Demand and Investment Drive the Economy
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¶7. (U) The combination of rising wages and more jobs have led to a boom in Poland's consumer sector and a huge increase in the spread of consumer durables and electronics. The NBP reports that consumption by individuals rose 5.2 percent in ¶2006. Increased retail sales were not the only signs of a boom. Real estate markets in Poland's major urban areas witnessed significant price inflation as supply failed to keep pace with the demand generated by Poland's growing middle class. Average apartments in cities such as Warsaw, Krakow, Wroclaw, Lodz, Poznan and Gdansk saw double digit price increases, with nicer properties preferred by trade-up buyers rising even more. Virtually all major Polish cities now have one or more new shopping centers under construction or about to open. Booming Wroclaw has three in the pipeline. Major shopping centers abutting the Warsaw and Krakow train

stations will open shortly.

¶8. (U) With the availability of numerous cheap flights to Western Europe, the Polish tourism sector is also thriving. The Polish Tourism Agency estimates that the number of foreign tourists spending at least one night in Poland reached 16.1 million in 2006, up from only 13 million in ¶2003. With only 40 hotel beds per 10,000 residents (versus 156 in Hungary), industry analysts expect a building boom in the next several years. The French hotel chain Accor, the largest hotel investor in Poland, reported its revenue per available room rose 10 percent in 2006. The group opened five new hotels in Poland in 2006 and has announced plans to build 5-10 additional ones in each of the next several years. Interestingly, Accor intends to build mostly one and two star hotels for the local market. It sees major growth in these categories where Poles are expected to make up more than 80 percent of the clientele. Many other hotel groups targeting the business traveler also have plans for expansion. The U.S. group Starwood will inaugurate the first Sheraton Hotel in Poznan this week. It will be the group's third in Poland. Another is currently under construction in Sopot. Warsaw's first Hilton Hotel is expected to open in February. Five-star hotel room rates in Warsaw, which were weak for years due to over-building, are now rising quickly.

¶9. (U) In contrast to previous years, Polish private sector investors and companies have finally turned bullish and have been eagerly embarking on new projects. The 16.7 percent jump in overall investment in 2006 was the largest since the mid-1990's. Reflecting the overall mood, the Polish stock market achieved record new listings in 2006 and also saw a huge run up in corporate valuations. The recent explosion of new real estate development company listings was cited by some economists as another indication that many Poles think there is money to be made in the construction sector. Economic growth has been further stimulated by growing net inflows of EU structural and Common Agricultural Policy funds. By some estimates, Poland received at least 3 billion more than it sent to the EU during 2006. That number is expected to rise steadily in coming years as Poland's local administrations get better at developing projects that will qualify for EU funding. While Poles will not be able to absorb all of the EU funding potentially available, the GOP has made it a top priority to increase the rate of absorption. The 2007-2013 EU plan potentially makes 60 billion Euro available for Poland.

Potentially available EU Funding for Poland
(Billion Euro)

2007	2008	2009	2010	2011	2012	2013
7.7	8.1	8.4	8.4	8.7	9.0	9.4

¶10. (C) As if this were not enough good news, the vice director of the National Bank of Poland indicates that there has been a huge increase in British pound remittances from Poles working in the UK. He estimates that Poland received more than 500 million pounds more of such inflows last year than in 2005, with the trend rising. The Polish government estimates that more than 300,000 Poles are now working more or less permanently in the UK and Ireland. It figures that these Poles will continue to send a good portion of their earnings back to their families in Poland for some time to come. The financial temptation for Poland's students to spend their summers tending bars in London or Dublin is a strong one. Less positively, Poland's hospital administrators fear that many of their most talented younger medical staff might move to Western Europe. Poland's newspapers frequently carry accounts of hospitals short of anesthesiologists and radiologists and of Polish doctors using cheap flights to moonlight at clinics in London on weekends. However, the trend does not yet seem to have become a mass one.

Foreign Investment Boom

¶11. (U) These strong positives have not gone unnoticed by foreign investors, who see a rapidly growing market for their products in Poland. Despite the recent pick up in growth, Polish wage rates are still extremely competitive (averaging

about $825 per month gross in September 2006), and the number of college graduates as a percentage of the 20-30 age bracket is now the highest in Europe. In 2006, more than 1.9 million students were enrolled in universities and colleges in Poland, compared with 2.3 million students at such institutions in Germany, which has more than twice Poland's population. In contrast to many EU countries, Poland's traditionally high unemployment rate has motivated Poland's students to study subjects (accounting, engineering, computer science, medicine, physical sciences) that will make them attractive to EU employers. Poland has seven major urban areas with more than 100,000 students.

¶12. (U) Foreign investors regard the country's abundance of reasonably priced engineers and computer scientists as among the top reasons to locate new technology investments in Poland. As a result, Poland attracted over $10 billion in direct investment in 2006, much of it from Asia. Poland emerged as the top destination in Europe for new investments in computers (Dell); plasma and LCD displays/televisions (Toshiba, Funai, LG-Philips, LG Electronics, Orion, TPV); motor vehicles and parts (Toyota, MAN, TRW, Cooper Standard, Johnson Controls, Michelin); and white goods (Electrolux, Diehl). Initial indications are that 2007 will also be a prosperous year. In January, Poland was able to announce new investments by Delphi and Kirchhoff (auto parts) and the sale of one of Poland's oldest aircraft firms PZL Mielec to United Technology's Sikorsky Helicopter Division.

The Boom May Be Just Beginning

¶13. (U) At a recent conference hosted by Poland's National Institute of Economics, Poland's top economists were unanimous that the country's fundamentals are currently so strong that the country can expect several more years of strong growth. The Institute forecasts that Poland's GDP will rise 6.0 in 2007, based on strong domestic demand and business investment. The positive mood is shared by Poland's National Bank, which in its recently published inflation report anticipates 5.8 percent growth in 2007, and roughly 5.0 percent in 2008 and 2009. Poland's economists are also confident that the unemployment rate will continue to fall steadily over the next several years. The combination of new domestic and foreign business investment and the removal of additional labor market barriers are expected to combine to take much of the surplus out of Poland's labor market. Thus the NBP conservatively expects unemployment to fall to around 10 percent in 2009. Indeed the NBP's biggest fear is that rapidly tightening labor markets will lead to a spiral of wage inflation which will erode Poland's competitiveness.

Comment

¶14. (C) Ironically, Poland's solid economic performance owes almost nothing to PIS Government policy. With five Finance Ministers since November 2005, constant sacking and reshuffling of senior officials in the Finance, Economics, and Treasury Ministries, and the replacement of many public sector company managers with inexperienced PIS cronies, few in Poland's private sector expect solutions to their problems to come from the Government. The Finance and Economics Ministries have shown no willingness at all to enact reforms that might be politically painful. The Treasury Ministry has privatized 11 percent of its 2006 target; the Transport Ministry has built neither roads nor new airports. There has been no progress on tough structural problems such as the need to restructure loss-making coal mine and shipyards, means-test entitlement spending, liberalize labor markets, or cut red tape. Most observers expect this state of affairs to continue to the next election. The GOP's failure to take advantage of the good times to implement necessary, but painful, reforms, has drawn criticism from both the IMF and the EU.

¶15. (C) Fortunately, the stability and market access provided by Poland's EU membership, the country's superb cadre of talented young university graduates, bullish foreign investment, rising EU funds inflows, and Poland's central geographical location are such strong pluses that they have allowed business to prosper despite the turmoil in the political sphere. To its credit, the GOP, after an early bout of populist hand-outs, also has refrained from enacting

any truly awful economic legislation or interfering with

business so profoundly that investment is choked off. Many of our business community interlocutors say that the Kaczynski brothers may know nothing about economics, but they are politically astute and cautious enough not to hurt the bird that lays the eggs.

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